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SIPDIS

SENSITIVE

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TAGS: EINV ECON ENRG PREL TU
SUBJECT: GAS MARKET UPDATE FROM EMRA AND BOTAS

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¶1. (SBU) Summary. Turkey's ambitious program to liberalize and privatize its natural gas market has stalled. The Energy Market Regulatory Authority (EMRA) told us that it has completed the necessary secondary regulations for the implementation of the Natural Gas Law and has already issued 32 licenses to new market entrants. Despite the initial progress, EMRA claims the transition to a competitive market is delayed, and an amendment to the Law is necessary because the Petroleum Pipeline Corporation (BOTAS), which currently holds a monopoly in the gas market, is reluctant to reduce its dominance in the sector. While admitting that BOTAS will not meet its legal obligation to transfer a 10 percent share of its import and wholesale obligations to private entities every year, BOTAS officials explained that it faced difficulties releasing gas contracts and complained that the liberalization process was becoming political. Close cooperation between EMRA and BOTAS remains key to successful gas market liberalization. End Summary.

¶2. (SBU) In separate meetings, EMRA and BOTAS discussed developments in gas market liberalization with Econoff and Econspecialist. EMRA told us on September 29 that the pace of liberalization in the natural gas market has slowed, although the secondary legislation is in place and Turkey is in compliance with the EU's Gas Directive. The Natural Gas Law passed in May 2001, and EMRA had initially envisioned a transiton period of 18-24 months to establish a competitive market. Under the Law licenses are required in order to engage in any natural gas market activity, and EMRA claims that the licensing process only takes one month. As of September 2003, 32 licenses have been issued: 8 for compressed natural gas (CNG); 9 for imports; 3 for wholesale; 7 for distribution; 2 for transmission; and 3 for storage.

¶3. (SBU) EMRA grants distribution licenses (10-30 years) through a tender process; all Turkish companies and registered foreign companies are elibible to participate. The Regulator is confident that it would be able to conclude tender procedures for 19 cities in 2003 as planned; tenders for Kayseri, Konya, Erzurum, Corlu, Gebze, Inegol, and Catalca have been completed. According to EMRA's timeline, construction of the facilities is to begin within 6 months of receiving a license, gas deliveries should start within 18 months, and the companies have 5 years to supply all eligible consumers. For example, the license for the Kayseri facility was issued in June and construction began on October
¶5.

¶4. (SBU) In the meeting on October 8, BOTAS was very critical of the Natural Gas Law, claiming that the model envisioned by this Law is unworkable for Turkey, arguing that the Law should not be technical but should be a code of practice. BOTAS told us that, in late September, its Board approved a Network Code, which establishes a code of conduct for all parties as the first step toward releasing gas contracts to permit new private entrants to import, wholesale, transmit, distribute, and store natural gas. BOTAS is legally obligated to transfer 10 percent of its market share annually until its wholesale market share is reduced to a maximum of 20 percent by 2009, but cannot meet the November 2003 deadline to start tranferring shares to the market for a variety of reasons.

¶5. (SBU) Although BOTAS has the sole authority to release gas contracts to buyers, most of these contracts have take-or-pay obligations and are liabilities instead of assets, making it difficult to find buyers. BOTAS also claims that there are confidentiality issues that would preclude tender nominees from viewing contract details beforehand. Germany and Austria were cited as countries facing similar problems liberalizing gas markets, and BOTAS emphasized that these countries have recently opted to use volume release instead of contracts to liberalize the market. Some contracts with project finance, such as Blue Stream and

Shah Deniz, have debt-service issues, further complicating any transfer. Given these complex contracts, BOTAS maintains that it cannot release liabilities without agreement from suppliers or partners. Another reason for the delay is that suppliers are reluctant to deal with new market entrants with an unproven record in the natural gas market, according to BOTAS. Under the current system, suppliers only face sovereign country risk since BOTAS is implicitly backed by the GOT and many of the current import contracts are state-to-state agreements; however, with market liberalization suppliers would face additional business or market risks that could raise costs.

¶6. (SBU) BOTAS claims that the World Bank understands the problems with the Law and supports amendments to facilitate market liberalization. The Energy Ministry is considering legislative fixes: the Ministry had initially planned to attach a clause to the pending Petroleum Law but has now decided to draft a separate amendment to the Natural Gas Law, according to BOTAS. The proposed amendment would extend the deadline for tranferring shares, but BOTAS is also exploring other clauses to alleviate gas release problems.

¶7. (SBU) BOTAS took the opportunity to respond to criticism about the slow pace of natural gas market liberalization and complained that the problem has become political. For example, BOTAS objected to charges by some politicians and EMRA's President that gas prices are higher because one-third of the cost comes from BOTAS' financial and operational costs. BOTAS contends that any buyer would face similar overhead costs. BOTAS also noted that the current Turkish government has reduced its reliance on natural gas and has a preference for indigenous energy sources. As a direct consequence, the State Electricity Generation Company (EUAS) used only 2 billion cubic meters (bcm) of natural gas this year as compared to 5 bcm in 2002. This helps to overstate Turkey's gas surplus and complicates decisions on how to assess and manage the domestic gas needs, according to BOTAS.

¶8. (SBU) Commenting on the domestic natural gas distribution network, BOTAS told us that two existing distribution networks, Bursa and Eskisehir were transferred to the Privatization Administration for sale. BOTAS also criticized EMRA for making price the most important criteria in the tender process and granting concessions mainly to construction companies, which may only be interested in building the facilities instead of operating these networks over the longer term. BOTAS emphasized that EMRA granted tenders to contractors for as low as TL 100,000 (.04 cents) per cubic meter, which is insufficient to lure prudent investors to the gas market because distributors cannot make a profit at such a low price when current retail prices are about 2.5 cents per cubic meter in big cities. BOTAS speculated that distribution companies eventually may levy a surcharge to each household to recoup losses from the low prices offered to win the tender. BOTAS also is concerned about the guarantee letter of up to $2 million that EMRA requires before granting the contract. With such a modest guarantee requirement, BOTAS fears that these construction companies would turn over the facilities to EMRA and walk away from the deal if unable to recover costs due to low prices. The guarantee letter would be miniscule compared to the overall cost of running the facility at the given price for the specified period.

¶9. (SBU) Comment. Relations between EMRA snd BOTAS appear to be strained and close cooperation remains essential to overcoming implementation hurdles and speeding up the pace of natural gas market liberalization. End Comment.
EDELMAN